

## SEC Regulations Committee Highlights

Joint Meeting with SEC Staff - May 26, 1999

*Location:* SEC Headquarters – Washington, D.C.

**NOTICE:** The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

### I. **ATTENDANCE**

#### A. **SEC Regulations Committee**

Robert H. Herz, Chairman  
Ernie Baugh  
Mark Bagaason  
Val Bitton  
Ed Coulson  
David Einhorn  
Wendy Hambleton  
Jay Hartig  
Terry Iannaconi  
Amy Ripepi  
Bob Rouse  
Stewart Sandman  
Bill Travis  
Bill Yeates  
Mary Jane Young

#### B. **Securities and Exchange Commission**

*Office of the Chief Accountant*

Lynn Turner, Chief Accountant  
Jack Albert, Associate Chief Accountant  
Scott Bayless, Associate Chief Accountant  
Eric Casey, Professional Accounting Fellow  
Pascal Desroches, Professional Accounting Fellow  
Andrew Hubacker, Assistant Chief Accountant  
Eric Jacobson, Professional Accounting Fellow  
Jeffrey Jones, Professional Accounting Fellow  
Mike Kigin, Associate Chief Accountant  
Robert Lavery, Assistant Chief Accountant  
Jenifer Minke-Girard, Assistant Chief Accountant

Richard Rodgers, Professional Accounting Fellow  
Bob Uhl, Professional Accounting Fellow

*Division of Corporation Finance*

Robert Bayless, Chief Accountant

*Division of Investment Management*

Brian Bullard  
John Capone

C. **AICPA**

Annette Schumacher Barr, Technical Manager

D. **Guests**

Jeff Womer, PricewaterhouseCoopers  
Scott Blackley, KPMG

II. **PERSONNEL CHANGES**

*Office of the Chief Accountant.* Lynn Turner announced that Jeff Jones, Bob Uhl and Joseph Godwin have nearly completed their fellowship terms with the Office of the Chief Accountant (OCA). Richard Rodgers and Eric Jacobsen have joined the OCA as Professional Accounting Fellows (PAFs). Andrew Hubacker and Jenifer Minke-Girard have joined the office as Assistant Chief Accountants. Two new PAFs, Dominick Ragone and Scott Taub, will be joining the office in June. J. Richard Dietrich will join as Academic Fellow beginning in August. Bob Lavery, a permanent OCA staff member, will be retiring. Mr. Turner also announced the OCA is searching for a second Deputy Chief Accountant and three additional staff members.

*Division of Corporation Finance.* Ken Marceron, Associate Chief Accountant in the SEC's Division of Corporation Finance recently announced that he will be leaving the SEC.

III. **STAFF ACCOUNTING BULLETINS (SABs)**

Mr. Turner stated that the staff expects to issue three SABs in the near term. These SABs will address the following issues:

- **Materiality** — Both qualitative and quantitative factors will be considered. In drafting this SAB, the staff is referring to a discussion document on materiality drafted by Big 5 representatives. The SAB will also address the issue of intentional errors. Mr. Turner stated that a company cannot record intentional errors and hide behind materiality. He believes that recording intentional errors goes against the Foreign Corrupt Practices Act (FCPA) and that such errors may be material for qualitative reasons. He added that auditors that become aware of FCPA violations that are not clearly inconsequential during the course of an audit should report them to the Audit Committee, regardless of materiality. The FCPA does not have a materiality clause. He added that firms should make sure all audit teams receive adequate training regarding the specifics of the FCPA and its many implications on audits and financial reporting.

- **Revenue Recognition** — Among other things, the SAB will describe the staff's views about accounting for "bill and hold" transactions (as described in AAER 108), as well as other recent registrant issues. Mr. Turner stated that the SAB will require the company to have persuasive evidence of an agreement, the sales price will need to be fixed or determinable and collectible, and delivery or performance must be substantially complete. If the registrant is a service company, revenue should be recognized as the service is performed. He added that registrants will not be allowed to record up-front revenue when significant obligations still exist. Registrants with both product and service revenues will be required to disclose revenue recognition policies for each separately.
- **Asset Impairments and Restructuring Charges** — Mr. Turner made the following observations with respect to this SAB: (1) It will be expanded to also address "other special charges"; (2) It will require restructuring "plans" to be completed in a short enough time that changes to the plan are not anticipated; (3) It will require plans to be sufficiently detailed; (4) It will emphasize the necessity to continually assess the useful life of recorded goodwill in relation to factors that are impacting the company; and (5) It will likely address capitalization of internal costs relating to acquisitions.

#### IV. **EARNINGS MANAGEMENT TASK FORCE**

Robert Bayless reported that the Earnings Management Task Force, which includes members from every industry group, is continuing its earnings management initiatives. Several companies with large restructuring and other charges were selected for review. Mr. Bayless's overall impression is that the task force has been highly effective in bringing accounting and disclosure issues to the attention of the necessary individuals. As a result, the task force may soon be able to turn their attention to other issues, such as segment reporting and customer acquisition costs.

#### V. **SEGMENT REPORTING**

Robert Bayless stated that the staff is concerned that (1) companies may be improperly aggregating their operating segments and (2) aggregations used by companies for external reporting purposes are not the same as the aggregations generated for internal decision making purposes. The staff will request internal reporting information when a company's segment reporting doesn't make sense in light of other information included in the filing.

#### VI. **CUSTOMER ACQUISITION COSTS**

The staff has recently seen large write-offs of customer acquisition costs and is concerned that management is not properly evaluating the useful lives of these costs at the time of their acquisition. The staff stated that amortization periods should be based upon management's evaluation of specific facts and circumstances, including customer attrition rates. The staff will not accept arguments that other companies in the same industry use the same amortization period.

#### VII. **YEAR 2000 READINESS AND DISCLOSURE**

The Committee noted that some companies have received letters from Brian Lane regarding their Year 2000 disclosures. The letters are addressed "Dear Chief

Financial Officer" and suggest that management reconsider its Year 2000 disclosures. The letters did not identify specific areas of deficiency. The Committee reported that registrants are confused by the letter's lack of specificity. Robert Bayless stated that registrants who have received this letter and have questions should call Shelley Parratt at (202) 942-2830 or the voice mail number contained in Mr. Lane's letter.

Mr. Turner asked whether any going concern opinions have been issued based on lack of Year 2000 readiness. No Committee members were aware of any such opinions.

#### VIII. **"AIRCRAFT CARRIER" PROPOSAL**

Robert Bayless commented that the proposal is being hotly debated. The staff has received many comment letters and understands that many more are still on the way. Bob Herz indicated that the AICPA will be submitting a comment letter shortly.

#### IX. **BEST PRACTICES**

Bob Herz and other Committee members urged the SEC staff to document and communicate its views on "best practices" for dealing with the staff as a follow-up to the best practices document issued by the AICPA in 1997. Lynn Turner stated that Eric Jacobsen is currently drafting a "best practices" policies and procedures manual. Following are certain items the staff will address in the manual:

- Electronic submissions of questions/requests should follow established protocol (including sending them to the appropriate e-mail box).
- Written requests are more likely to be answered than verbal (telephone) requests.
- Telephone requests will be non-binding on the staff.
- Written submissions should be sent prior to a meeting with the staff.
- The company's (and their independent accountant's) conclusions should be included in all written submissions sent to the staff.

Lynn also indicated that the staff is incorporating many views expressed by the AICPA in its 1997 document. Several of the ideas from the SEC's "best practices" manual will be shared with the business community once the manual has been completed. The document is expected to be very useful in helping registrants and the staff to work together efficiently and effectively.

#### X. **BLUE RIBBON PANEL ON AUDIT COMMITTEES**

On February 8, 1999, the New York Stock Exchange (NYSE), the National Association of Securities Dealers (NASD) and the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees released its report announcing ten far-reaching recommendations to improve the quality of corporate financial reporting.

The Committee asked how the recommendations were going to apply to companies with small market capitalizations (the ten points were directed only to companies with market caps in excess of \$200 million). The staff pointed out that the issue regarding smaller companies needs to be resolved by the stock exchanges and not

the staff.

Based on comments received by the staff, it appears that companies are generally supportive of the recommendations, but have some cost-benefit concerns with implementing certain items. Lynn Turner observed that if the report is used well, it will help the profession.

**XI. BLUE RIBBON PANEL ON AUDIT EFFECTIVENESS**

Lynn Turner reported on his expectations of the panel on audit effectiveness. The panel is conducting three public meetings around the country. Quasi peer reviews are being performed in order to summarize audit testing, documentation, the level of business expertise, independence matters and other factors for ultimate review by the panel. Lynn is hopeful that the panel will produce a credible report, adding that a credible report would help the profession.

**XII. IN-PROCESS RESEARCH AND DEVELOPMENT**

The Committee noted that the finalization of the recommendations of the AICPA working group on IPR&D is taking longer than anticipated. Lynn Turner believes that most of the delay is due to discussion by the valuation experts on the valuation aspects of IPR&D. Lynn encouraged the profession to expeditiously go forward with the project and move it to a conclusion. He also stated that the firms need to "stand tall in the saddle" and support the FASB's efforts in this area. He commended the profession for taking a tough stand on this issue in calendar year 1998 audits.

**XIII. DELAY OF FAS 133 EFFECTIVE DATE**

The staff noted that it is supportive of the reasons for the delay in the effective date for FAS 133 but emphasized that this will be the first, last and only delay. However, the staff also emphasized that efforts in the next year should be directed to implementing the standard and not changing it. The staff will expect implementation of the standard to be of a very high quality. Lynn Turner stated that he is urging companies to get their derivative issues to the DIG for resolution, emphasizing that there will be no appeal to other standard setters (such as the EITF) for derivative questions requiring resolution by the staff.

**XIV. ALLOWANCE FOR LOAN LOSSES**

The SEC is supportive of the Federal Reserve Board's letter on loan loss reserves. Pascal Desroches is currently working on revisions to Industry Guide 3 and hopes to get final revisions out by the first quarter of next year.

Bob Herz briefly described part of the FASB's Business Reporting Research Project being conducted by Terry Iannaconi regarding Guide 3 and suggested that Terry meet with Pascal and others on the SEC staff to discuss the results of her research.

**XV. INTERNATIONAL ACCOUNTING STANDARDS (IAS)**

The SEC staff indicated that it intends to issue a concept release on IAS. The concept release will address matters such as the quality of financial statement audits and

independence, in addition to IAS.

The Committee asked who would be replacing Paul Leder. Paul's replacement as Deputy in OIT is Felice Friedman.

**XVI. SEGMENT DISCLOSURES FOR A NON PUBLIC ACQUIREE**

A member of the Committee described a comment received by the SEC staff asking a client to provide Statement 131 segment disclosures in a private acquirer's Rule 3-05 financial statements and pointed out that the SEC previously stated that segment disclosures required under Statement 14 would not be required in 3-05 financial statements under these circumstances. Robert Bayless told the Committee member that he would review the circumstances and provide clarification to the staff, if necessary.

**XVII. AUDITOR INDEPENDENCE**

The SEC staff continues to be concerned with auditor independence. Another enforcement proceeding (Moore Stephens) has been brought against a member of the accounting profession. Lynn Turner reminded the Committee that the SEC's independence rules run to all audits of SEC registrants around the world as well as in the U.S. He stated as an example the staff's concern regarding auditors providing legal services in Europe.

Mr. Turner stated that the staff is seeing more and more enforcement cases involving independence rules violations. He added that the firms need to take independence issues more seriously, adding that the first question enforcement staff will ask is "What action did the firm take against the individuals involved in the violation?" He asked Committee members to provide him with their firms' internal policies regarding independence violations.

Mr. Turner stated that he had recently made a speech at the AAA/NASBA Conference in which he elaborates on his concerns regarding auditor independence. The speech can be obtained from the SEC's website at [www.sec.gov](http://www.sec.gov).